Malaysian Government 2025 Budget: A step in the right direction if executed well

Summary

- The Federal Government's 2025 Budget laid out plans to fuel resilient economic growth by reducing its budget deficit further, reducing subsidies and introducing new taxes. Meanwhile, increasing minimum wage, cash handouts and tax reliefs to address cost of living issues of lower and middle income groups. An expansionary budget with RM421bn expenditure, +3.3% YoY to drive a projected economic growth of 4.5% to 5.5% in 2025. The fiscal deficit is projected to drop to 3.8% of 2025 Gross Domestic Product, GDP (4.3% in 2024), as subsidies will be cut by 14%, but this is balanced by higher cash handouts. **Reducing subsidies and introducing new taxes is a positive sign of the Government's political will to address the issue of government debt and narrow tax base.**

- **Hence, we believe this budget is a step in the right direction to address the long-standing issue of reducing the budget deficit which if executed well, could be positive on Malaysia's sovereign credit rating and MYR currency over the medium term.** In the short term, concerns that these measures could be mildly inflationary. Hence, a **neutral outlook on MYR bonds**. **On Malaysia equities: Positive for Aviation, Brewers, Gaming, REITs, Consumer, Property sectors; Neutral for Autos, Banking, Construction, Technology, Utilities sectors; Negative for Gloves & Manufacturing, Oil & Gas, Plantation sectors.**

Analysis

- **Subsidy reduction and new taxes are key themes, spending to rise marginally, widening social safety net.** The Federal government's operating expenditure is planned to grow +4.2% YoY to RM335bn in 2025 (2024E: +3.3% YoY) mainly driven by emoluments, pension & gratuities, with no increase in development expenditure (2025F: RM86bn). Key infrastructure development projects are RM9.7bn Pan Borneo Sabah Highway (Phase 1B), RM7.4bn Sarawak-Sabah link road (Phase 2), Johor-Singapore Rapid Transit System (RTS), Kerian Integrated Green Industrial Park in Perak, additional lane for Lebuhraya Utara Selatan (PLUS) from Yong Peng to Senai Utara (Phase 3) in Johor, Pulau Pinang Light Rail Transit (LRT). To improve living standards of low and middle income group, cash handouts will improve by RM3bn to RM13bn under the Rahmah programme, while the minimum monthly wage will be raised to RM1,700 from RM1,500. To extend social security, mandatory employee provident fund (EPF) contributions will be made by foreign workers. The key thrust of 2025 Budgetary proposals were designed to reduce subsidies and introduce new taxes or broaden the tax base.

- **Key subsidy reduction measures, new taxes and relief increases:**
  - **Reduce petrol (RON95) subsidies** starting mid-2025, targeting the top 15% income earners and foreigners, with RM8bn potential fiscal savings
  - **Education and healthcare subsidies** will be gradually reduced for top 15% income earners.
  - **2% dividend tax** on individuals receiving annual dividend income exceeding RM100,000 effective from 2025; NOT applicable to dividends received from EPF, Lembaga Tabung Angkatan Tentera, Amanah Saham Nasional Bumiputera, unit trusts, foreign companies and pioneer status companies
  - **Broadening of Sales and Service tax base** from May 2025 onwards, encompassing sales tax rate increases on non-essential and imported items and expanding the scope of service tax to include commercial service transactions between businesses, such as fee-based financial services.
  - **Excise duty rate on sugar-sweetened beverages** will increase in phases beginning Jan 2025 from 50 sen to 90 sen per litre
  - **Carbon tax** will be introduced starting 2026 on iron, steel and energy industries.
  - **Tax exemption of foreign source income** received by individual residents in Malaysia extended until 2036, from 2026 currently.
  - Individual income tax relief on **first residential home loan interest payment** for 3 consecutive years on residential home purchase in 2025 to 2027, of up to RM7,000 tax relief per year for residential home price up to RM500,000, or up to RM5,000 tax relief per year for residential home price above RM500,000 up to RM750,000.
  - Individual income tax relief limit on **education and medical insurance premium,** increase to RM4,000 from RM3,000
  - Individual income tax relief for **disabled persons** increase to: RM7,000 from RM6,000 for taxpayer; RM6,000 from RM5,000 for taxpayer's spouse; RM8,000 from RM6,000 for taxpayer's unmarried children.

Federal Government Fiscal Position	2024 Revised (RM bn)	2025 Forecast (RM bn)	2025F (% of GDP)
Revenue	322.1	339.7	16.3
Tax	241.1	259.0	12.4
Direct Tax	177.1	188.8	9.0
Indirect Tax	64.0	70.2	3.4
Non-tax	81.0	80.7	3.9
Operating Expenditure	321.5	335.0	16.1
Subsidies	61.4	52.6	2.5
Current Balance	0.6	4.7	0.2
Net Development Expenditure	84.8	84.7	4.0
Gross Development Expenditure	86.0	86.0	4.1
Fiscal Balance	-84.3	-80.0	-3.8

Source: Ministry of Finance, Malaysia

- **Economic growth and subsidies.** The government projected GDP growth of 4.5%-5.5% in 2025 (2024E: 4.8%-5.3%). For context, GDP grew by 4.2% YoY in 1Q2024 and accelerated 5.9% in 2Q2024. The total subsidy bill is projected to fall to RM52.6bn in 2025 (2.5% of GDP), from RM61.4bn in 2024E (3.2% of GDP).

- **Interest rates, bond issuance and market outlook:** Based on the budgeted lower fiscal deficit of RM80bn for 2025 (2024E: RM84.3bn), sovereign bond issuance is expected to be no higher than RM179bn in 2025 (2024E: RM183bn) due to government's intention to partially substitute bills with bonds (RM9bn forecasted in 2025), with total expected sovereign bond maturities of RM83.5bn in 2025 (2024: RM93bn) and the potential RM6bn partial pre-funding of 2026 maturities. Robust demand for sovereign bonds from local institutions is expected to support the issuances in 2025, hence **neutral outlook on MYR sovereign and corporate bonds**. BNM is expected to maintain policy rate at 3% in 2025, based on resilient economic growth and moderately higher inflation rate of 2% to 3.5% (2024E: 1.5% to 2.5%). *(Source: Ministry of Finance, Malaysia and CIMB Treasury and Markets Research).*

- **Sovereign debt load and sovereign credit ratings**: A slightly higher sovereign debt to GDP ratio of 64% projected in 2025 (June 2024: 63.1%), coupled with the on-going fiscal consolidation (average fiscal deficit to GDP target of 3.5% for 2025-2027), and improving fiscal outlook should keep Malaysia's sovereign credit ratings at A3/A-/BBB+ by Moody's, S&P and Fitch respectively, with stable outlook; and thus **no rating concerns**.

Industries or sectors affected by Budgetary measures:

POSITIVE

- **Aviation, Brewers, Gaming & REITs** – The RM550mn allocation towards Visit Malaysia 2026 should attract tourist arrivals. The expected influx of international visitors will increase revenues for tourism-related beneficiaries, in particular **Malaysia Airports**; brewers such as **Heineken Malaysia**; and REITs leveraged to retail and hospitality such as **KLCCP Stapled Group and IGB REIT**.

- **Consumer** – The higher minimum wage, increase in cash handouts to RM13bn (from RM10bn in 2024) supporting 9 million beneficiaries (60% of Malaysia's adult population) coupled with pay hike for civil servants announced earlier, will benefit mass-market retailers such as **99 Speed Mart, Mr DIY and Aeon** – although mandatory EPF contribution for non-citizen workers will raise operating costs. The sugar tax hike to 90 sen per litre (from 50 sen per litre) will increase costs for beverage players, but could be mitigated via tweaking product formulation.

- **Property** – First-time homebuyers will benefit from incentives including: i) annual tax relief of up to RM7,000 for housing loan interest on residential properties priced up to RM750,000, purchase from 2025 to 2027 ii) a new 'step-up financing scheme' providing government guarantee of up to RM5bn which will lower loan repayments for the first 5 years. Separately, the government indicated that special incentives for the Johor-Singapore Special Economic Zone will be announced by year-end, coupled with the setup of 'Invest Malaysia Facilitation Centre-Johor' to facilitate investments and expedite approvals. Overall, these will bode well for property developers in boosting demand especially for first-time homebuyers and those with landbank in Johor. Our stock picks are **SP Setia and Eco World Development**.

NEGATIVE

- **Gloves & Manufacturers** – The minimum monthly wage hike to RM1,700 (from RM1,500) from 1 February 2025 and mandatory EPF contribution for non-citizen workers will increase production costs for the manufacturing sector. For glove players, labour costs are about 10% of total costs. However, the impact could be partly mitigated through higher average selling prices, given the strong demand due to tariffs imposed by the US on gloves from China.

- **Oil & Gas** – RON95 subsidy rationalisation will begin in mid-2025, affecting the top 15% of income earners. This, coupled with the growing adoption of electric vehicles and improvements in public transportation, will reduce sales volumes at petrol stations; a negative for **Petronas Dagangan**.

- **Plantations** – The threshold of the Windfall Profit Levy on CPO prices will rise to RM3,150 per metric ton (MT) for Peninsular Malaysia (previous: RM3,000 per MT) and RM3,650 per MT for Sabah and Sarawak (previous: RM3,500 per MT). This benefits upstream players. However, there are greater negatives from the increase in minimum wages and the foreign worker levy set for 2025.

NEUTRAL

- **Autos** – **Sime Darby** would be less impacted by the eventual RON95 subsidy rationalisation given their exposure to middle-income customers through Perodua and Toyota. While no new incentives for Electric Vehicle (EV) buyers or manufacturers were announced, neither was there any mention of a luxury goods tax implementation.

- **Banks** – Service tax scope expansion to include fee-based financial services effective 1 May 2025 could increase financial transaction costs; marginally negative for banks' earnings if they absorb the costs. Details of the impacted services, however, are yet to be known.

- **Construction** – No mention of mega projects such as Klang Valley Mass Rapid Transit, MRT 3 or Malaysia-Singapore High Speed Rail (HSR) as the government is prioritising smaller, state-specific construction projects. Among the key projects mentioned are Kerian Integrated Green Industrial Park (KIGIP), Johor-Singapore RTS, Penang LRT, various renewable energy projects, and highway and airport expansion projects across several states. RM7.4bn of contracts is finalised for the Sabah-Sarawak Link Road Phase 2, with contracts to be awarded by year-end, and an additional RM9.7bn for the Pan Borneo Highway Phase 1B. Large construction companies like **Gamuda and IJM Corp** stand to gain from these projects.

- **Technology** – The government emphasised its commitments through tax incentives on advancing its semiconductor, Electrical & Electronics (E&E) and Artificial Intelligence (AI) sectors through further education, Research & development (R&D) and industrial collaboration. There remains growing emphasis on attracting investments into higher value activities like Integrated Circuit (IC) designs and advanced packaging. We believe local semiconductor companies like **Inari, Nationgate and Frontken** amongst others would be encouraged to explore ways to move up the supply chain.

- **Utilities** – **Tenaga** and UEM Lestra, a subsidiary of UEM Group which is in turn wholly-owned by Khazanah, will invest RM16bn to increase transmission and distribution network capacity, signalling the regulator's commitment to grid upgrades. This investment could be a prelude to higher capex in the upcoming Regulatory Period 4, which would boost Tenaga's regulated earnings. However, the proposed introduction of a carbon tax in 2026 will likely raise regulatory costs due to the sector's high carbon emissions.

- **Our Fund picks for Malaysia** based on the above budget proposals are:
  - Principal Lifetime Balanced Income Fund
  - Principal Islamic Lifetime Balanced Fund (*Shariah*)
  - Principal Malaysia Titans
  - AHAM Select Opportunity
  - Singular Value Fund *(For Private Banking Clients Only)*

CIMB preferred

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